

INVOLUNTARY CONVERSION TREATMENT FOR RED- WOOD TRACTS TAKEN FOR PARK

DECEMBER 18, 1970.—Committed to the Committee of the Whole House on the
State of the Union and ordered to be printed

Mr. ULLMAN, from the Committee on Ways and Means, submitted
the following

REPORT

[To accompany H.R. 14873]

The Committee on Ways and Means, to whom was referred the bill (H.R. 14873) relating to the income tax treatment of just compensation received from the United States with respect to property taken under the act of the Congress which established the Redwood National Park, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert the matter that appears in italic in the reported bill.

I. SUMMARY

This bill (H.R. 14873) is concerned with the reinvestment of money and property received by taxpayers for property taken by the United States under the act establishing a Redwood National Park in California (Public Law 90-545, Oct. 2, 1968). It provides, in general, that, if the taxpayer so elects, for Federal income tax purposes, gain is not to be recognized to corporate taxpayers in the case of money received from the United States for the redwood tracts, if the money is reinvested in property to be used in any trade or business of the same kind as those in which the corporation (or a subsidiary) was engaged on the date the redwood tracts were taken (October 2, 1968). A similar rule applies to cash received on the sale of property which the taxpayer received from the United States in payments for the redwood tracts taken. In addition, where certain conditions are met, the use of money obtained by the corporation from the United States for the redwood tracts taken (or from the sale of property received from the United States in exchange for the redwood tracts) which is used to redeem its

own stock, is to be treated as a reinvestment for purposes of this provision.

The bill has been reported unanimously by your committee and the Treasury Department has indicated that it has no objection to its enactment. The Department of the Interior supports the bill as amended.

II. REASONS FOR THE BILL

On October 2, 1968, Congress enacted an act to establish a Redwood National Park in the State of California, and for other purposes (hereafter called the Redwood Act). One provision of that act (sec. 3(b)(1)) reads in part:

Effective on the date of enactment of this act, there is hereby invested in the United States all right, title, and interest in, and the right to immediate possession of, all real property within the park boundaries designated in maps, etc. * * *

Because of this provision, the redwood timberlands of a number of taxpayers were taken for public use. The taxpayers involved have been, or will be, paid in part in cash and in part in other timberland which the United States will give in exchange for the property taken. The value of the land taken and, in some cases, the land received, or to be received, is still being discussed and may be litigated. The land taken was of substantial value and, in some cases, amounted to a considerable portion of the assets of the taxpayers involved.

While it would be possible for the taxpayers involved to purchase other timberlands, the supply of redwood timber is limited, so that it would not be possible in many situations for them to obtain redwood timber tracts as large as, or of the same quality as, those of which they were deprived by the taking. Moreover, some of the taxpayers were engaged only in redwood logging, manufacturing, and sales activity, and did not deal in, and do not intend to deal in, other kinds of timber, although they are engaged in other types of business.

Since it will not be possible for the taxpayers, in all cases, to reinvest in property which will enable them to engage in redwood lumbering, your committee believed it was appropriate to permit them to invest in other businesses of the same kind as those in which they were engaged on the date of the taking (October 2, 1968).

It should be noted that, in many respects, the relief granted by this bill is similar to the relief granted under a present tax provision (sec. 1071 of the code) which treats as involuntary conversions for tax purposes the gain or loss on the sale of radio stations required to carry out a change in the policies of the Federal Communications Commission where the funds are reinvested in the stock of corporations operating radio stations. Under that section corporations need not recognize gain in those cases where the basis of depreciable property they hold is reduced by the amount of the gain which otherwise would be recognized. The relief in this bill also resembles that granted under the tax laws (sec. 1081) in the case of exchanges and distributions in obedience to orders of the Securities and Exchange Commission.

III. EXPLANATION OF THE BILL

The application of the bill is restricted to taxpayers which meet three qualifying conditions. First, it applies only to a taxpayer which is a domestic corporation and which has had property taken by the United States under the Redwood Act.

Second, the bill applies only at the election of the taxpayer.

Third, the bill applies only if the taxpayer agrees to accept compensation in the form of property offered by the United States under the terms of the Redwood Act in exchange for the property taken. It is the understanding of the committee that the property to be offered by the United States is to be limited to that in the redwood exchange unit. However, the acceptance of the property does not involve any concession by the taxpayer as to the value of the property surrendered or as to the value of the property received. In other words, the right to litigate as to all values is retained by the taxpayer. This condition was added to the bill at the specific request of the Department of the Interior.

A taxpayer which meets the three qualifications under the bill is to be eligible for any or all of three benefits:

(1) the class of property in which it may reinvest, in order to obtain deferment of gain (under sec. 1033 of the code), is significantly expanded,

(2) it may redeem its own stock under certain conditions and treat this as a reinvestment, and

(3) it may sell property it received from the United States without the recognition of gain if it reinvests the proceeds in property qualifying under the involuntary conversion provision (including categories No. (1) and (2) above).

These three benefits are described in more detail below.

Expansion of permitted reinvestment.—The usual rule for property qualifying under the involuntary conversion provision (sec. 1033 of the code) is that the reinvestment must be in property "similar or related in service or use" to the property converted. However, in the case of real property seized by condemnation it is sufficient if the real property purchased is of "like kind", a substantially more liberal test.

The bill provides that a corporation which qualifies may reinvest without the recognition of gain (to the extent of the reinvestment) in any property to be held for productive use in any trade or business of the same kind as one in which it, or a domestic corporation controlled by it, was engaged on October 2, 1968. In other words, in this case these reinvestments are to be treated as "similar or related in service or use" (for purposes of sec. 1033). The control test applicable in this case is the 80 percent test used in the involuntary conversion provision.

The period during which reinvestment may be made is to expire on December 31, 1973 (or 3 years after the close of the taxable year in which the amount to be reinvested was received, if later).

Redemption of own stock as reinvestment.—If the taxpayer so chooses, instead of purchasing new property, it may reinvest, without the recognition of gain, in the purchase and redemption of its own stock. It may make qualifying reinvestments in this manner of payments received under the Redwood Act only to the extent it issued stock in the 5-year period January 1, 1967 through December 31, 1971, to acquire control of a corporation. The stock redeemed or purchased

under this provision by the corporation need not be the same shares of stock issued in the acquisitions so long as it is no larger, in number of shares with respect to each class of stock, than that issued for the acquisitions.

If the taxpayer chooses to purchase or redeem its stock this provision, then the gain not recognized because of this provision is to reduce the basis (for depreciation and gain or loss purposes) of property held by the subsidiary corporations in which the taxpayer acquired control in the 5-year period referred to above or had control at the beginning of this period. These basis adjustments are to be made:

First, to any property similar or related in service or use to the property converted,

Second, to any property which is property of a character subject to the allowance for depreciation (under sec. 167 of the code),

Third, to any other tangible property, and finally, to any intangible property.

Reinvestment of proceeds on sale of property received from the United States.—As indicated previously the bill provides that a taxpayer which received property from the United States in the form of purchase units designated by the Redwood Act and offered by the Secretary of the Interior may sell this property and reinvest the proceeds to qualify for this treatment and receive involuntary conversion treatment for tax purposes. However, both the sale and the reinvestment must take place within 3 years of the exchange with the Government. This treatment is obtained by treating the cash proceeds received on the subsequent sale as if they were received for the property originally surrendered to the United States.

IV. SECTION 1033 OF THE INTERNAL REVENUE CODE OF 1954

For the information of the Members, the text of section 1033 of the Internal Revenue Code of 1954, which is referred to in section 2 of the bill, as reported, is as follows:

SEC. 1033. INVOLUNTARY CONVERSIONS.

(a) **GENERAL RULE.**—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

(1) **CONVERSION INTO SIMILAR PROPERTY.**—Into property similar or related in service or use to the property so converted, no gain shall be recognized.

(2) **CONVERSION INTO MONEY WHERE DISPOSITION OCCURRED PRIOR TO 1951.**—Into money, and the disposition of the converted property occurred before January 1, 1951, no gain shall be recognized if such money is forthwith in good faith, under regulations prescribed by the Secretary or his delegate, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund. If any part of the money is not so expended,

the gain shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more taxable years and regardless of whether or not the money which is not so expended constitutes gain). For purposes of this paragraph and paragraph (3), the term "disposition of the converted property" means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation. For purposes of this paragraph and paragraph (3), the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

(3) **CONVERSION INTO MONEY WHERE DISPOSITION OCCURRED AFTER 1950.**—Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) **NONRECOGNITION OF GAIN.**—If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe. For purposes of this paragraph—

(i) no property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(ii) the taxpayer shall be considered to have purchased property or stock only if, but for the provisions of subsection (c) of this section, the unadjusted basis of such property or stock would be its cost within the meaning of section 1012.

(B) **PERIOD WITHIN WHICH PROPERTY MUST BE REPLACED.**—The period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—

(i) 2 years after the close of the first taxable year in which any part of the gain upon the conversion is realized, or

(ii) subject to such terms and conditions as may be specified by the Secretary or his delegate, at the close of such later date as the Secretary or his delegate may

designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe.

(C) TIME FOR ASSESSMENT OF DEFICIENCY ATTRIBUTABLE TO GAIN UPON CONVERSION.—If a taxpayer has made the election provided in subparagraph (A), then—

(i) the statutory period for the assessment of any deficiency, for any taxable year in which any part of the gain on such conversion is realized, attributable to such gain shall not expire prior to the expiration of 3 years from the date the Secretary or his delegate is notified by the taxpayer (in such manner as the Secretary or his delegate may by regulations prescribe) of the replacement of the converted property or of an intention not to replace, and

(ii) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of section 6212 (c) or the provisions of any other law or rule of law which would otherwise prevent such assessment.

(D) TIME FOR ASSESSMENT OF OTHER DEFICIENCIES ATTRIBUTABLE TO ELECTION.—If the election provided in subparagraph (A) is made by the taxpayer and such other property or such stock was purchased before the beginning of the last taxable year in which any part of the gain upon such conversion is realized, any deficiency, to the extent resulting from such election, for any taxable year ending before such last year may be assessed (notwithstanding the provisions of section 6212(c) or 6501 or the provisions of any other law or rule of law which would otherwise prevent such assessment) any time before the expiration of the period within which a deficiency for such last taxable year may be assessed.

(b) RESIDENCE OF TAXPAYER.—Subsection (a) shall not apply, in the case of property used by the taxpayer as his principal residence, if the destruction, theft, seizure, requisition, or condemnation of the residence, or the sale or exchange of such residence under threat or imminence thereof, occurred after December 31, 1950, and before January 1, 1954.

(c) BASIS OF PROPERTY ACQUIRED THROUGH INVOLUNTARY CONVERSION.—If the property was acquired, after February 28, 1913, as the result of a compulsory or involuntary conversion described in subsection (a) (1) or (2), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made. This subsection shall not apply in respect of property acquired as a result of a compulsory or involuntary conversion of property used by the taxpayer as his principal residence if the destruction, theft, seizure, requisition, or condemnation of such residence, or the sale or exchange of such residence under threat or imminence thereof,

occurred after December 31, 1950, and before January 1, 1954. In the case of property purchased by the taxpayer in a transaction described in subsection (a)(3) which resulted in the nonrecognition of any part of the gain realized as the result of a compulsory or involuntary conversion, the basis shall be the cost of such property decreased in the amount of the gain not so recognized; and if the property purchased consists of more than one piece of property, the basis determined under this sentence shall be allocated to the purchased properties in proportion to their respective costs.

(d) **PROPERTY SOLD PURSUANT TO RECLAMATION LAWS.**—For purposes of this subtitle, if property lying within an irrigation project is sold or otherwise disposed of in order to conform to the acreage limitation provisions of Federal reclamation laws, such sale or disposition shall be treated as an involuntary conversion to which this section applies.

(e) **LIVESTOCK DESTROYED BY DISEASE.**—For purposes of this subtitle, if livestock are destroyed by or on account of disease, or are sold or exchanged because of disease, such destruction or such sale or exchange shall be treated as an involuntary conversion to which this section applies.

(f) **LIVESTOCK SOLD ON ACCOUNT OF DROUGHT.**—For purposes of this subtitle, the sale or exchange of livestock (other than poultry) held by a taxpayer for draft, breeding, or dairy purposes in excess of the number the taxpayer would sell if he followed his usual business practices shall be treated as an involuntary conversion to which this section applies if such livestock are sold or exchanged by the taxpayer solely on account of drought.

(g) **CONDEMNATION OF REAL PROPERTY HELD FOR PRODUCTIVE USE IN TRADE OR BUSINESS OR FOR INVESTMENT.**—

(1) **SPECIAL RULE.**—For purposes of subsection (a), if real property (not including stock in trade or other property held primarily for sale) held for productive use in trade or business or for investment is (as the result of its seizure, requisition, or condemnation, or threat or imminence thereof) compulsorily or involuntarily converted, property of a like kind to be held either for productive use in trade or business or for investment shall be treated as property similar or related in service or use to the property so converted.

(2) **LIMITATIONS.**—

(A) **PURCHASE OF STOCK.**—Paragraph (1) shall not apply to the purchase of stock in the acquisition of control of a corporation described in subsection (a)(3)(A).

(B) **CONVERSIONS BEFORE JANUARY 1, 1958.**—Paragraph (1) shall apply with respect to the compulsory or involuntary conversion of any real property only if the disposition of the converted property (within the meaning of subsection (a)(2)) occurs after December 31, 1957.

(h) **CROSS REFERENCES.**—

(1) For determination of the period for which the taxpayer has held property involuntarily converted, see section 1223.

(2) For treatment of gains from involuntary conversions as capital gains in certain cases, see section 1231 (a).

(3) For exclusion from gross income of certain gain from involuntary conversion of residence of taxpayer who has attained age 65, see section 121.

